HOW TO UNDERSTAND THE BALANCE SHEET AND Other Periodical Statements

BY

A CHARTERED ACCOUNTANT

SECOND EDITION

London:

JORDAN & SONS, LIMITED

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JORDAN & SONS, LIMITED
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INTRODUCTION.

THE object of these pages, it may be broadly stated, is to explain without the use of confusing technicalities—

1. The Constitution of the Balance Sheet.

2. Typical Balance Sheet items.

3. The essential difference in principle between the Balance Sheet and certain other periodical accounts commonly in use.

The general public by no means thoroughly comprehend such documents, nor can it reasonably be otherwise expected; these accounts are of necessity far from being of a simple nature, though it would seem that many of those who know the least of scientific book-keeping and accounts discourse the most of the simplicity of such matters. The public at large, however, do not in the first place rightly grasp the principles upon which the

different accounts are constructed, whilst confusion is added by the pitfalls that some Balance Sheet items provide on sundry occasions for the uninitiated. To this need of information may in no small degree be ascribed the listless attitude characteristic of Shareholders in Limited Companies, to whom these explanations it is hoped will be especially useful. The want of confidence in one's self to form a reliable opinion upon a technical document whereby one is more or less confused is a serious obstacle which it is the writer's aim to remove.

It will be seen that the specimen Balance Sheet herewith is made out as for a Limited Company, for the reason that Shareholders in such concerns form the most numerous class interested in the subject. But, needless to say, these pages are not thereby dedicated to one class alone; they are addressed to all who may be interested and who have no special acquaintance with the intricacies of accountancy, for the principle is always the same, be the Balance Sheet that of a Limited Company or of any other concern or organisation.

The writer has had ample evidence of the difficulties presented by technical accounts to the therein uninstructed or popular world whence comes the material of which the average Shareholder in Limited Companies is made, and the many erroneous views that have come under his notice have been the means of suggesting to him that a short explanatory work on the lines above stated might supply what would appear to be a pressing need of the community—no treatise upon Book-keeping, but dealing with results as shown by the usual and periodical statements, and not with the manifold transactions that lead to those results; and these designs as expressed in the title are treated in popular language between the covers.

The reader is now particularly recommended to direct his attention upon the information contained in the two following pages, 8 and 9.

The following is a **Key** to the principle of all the slightest knowledge of scientific book-keeping statements. Like other generalities it is subject to

X. Y. Z. & SONS. Balance

DEBIT SIDE. [Filled up with the proper particulars, this side of the Balance Sheet would show X. Y. Z. & Sons' **Receipts** of money or money's worth, but only those Receipts that remained **Liabilities** owing, at 31st March, 1905, by X. Y. Z. & Sons to various persons indicated by the said particulars. The opposite side would show what has become of these Receipts.]	£ *s.* *d.* [Inner column supplementary to the outer column, for adding and subtracting.]	£ *s.* *d.* [Outer column. £

Bear in mind that the Debit side sets forth what Receipts it has had at various times in the past.

Avoid the pitfall of supposing the Debit side single one of those Receipts.

The Debit side shows what the concern has shows what the concern still **has**.

By the Debit side we are informed to whom

The reader should carefully observe the above wherein he will in due course be referred to the conclusion.

3alance Sheets, enabling even those who possess not r accounts to understand the construction of such xceptions, which are dealt with in due course.

Sheet at 31st March, 1905.

Credit Side.	£ s. d.	£ s. d.
[Filled up with the proper particulars, this side of the Balance Sheet would show X. Y. Z. & Sons' **Possessions** at 31st March, 1905, that have been obtained through the Receipts opposite. This side should show, therefore, what Assets the firm of X. Y. Z. & Sons has, to meet its Liabilities stated on the other side.]	[Inner column supplementary to the outer column, for adding and subtracting.]	[Outer column.]
		£

i owing by a concern at date of Balance Sheet for

o state that the concern is still in possession of any

ad and still owes for. It is the Credit side that

te Possessions, stated on the Credit side, belong.
utline before resorting to the subsequent pages,
specimen Balance Sheet that brings them to a

CHAPTER I.

THE BALANCE SHEET.—PRELIMINARY REMARKS.

THE BALANCE SHEET is a statement of one's financial position, made up as a rule annually, and so bringing to a close the financial year. Its aim is to show the position at the end of a period, and *not* the transactions for or during a period. The numerous transactions that take place cannot either conveniently or usefully be shown in detail in such a statement, and it is the net result at a given date of what has taken place from the time when one's financial operations were first commenced that the Balance Sheet sets forth.

A simple example may here be useful. At the close of 1900 an imaginary Thomas Brown's furniture, purchased on some previous occasion or occasions, had cost £400. During 1901 he made a further purchase of furniture that was to be paid for in four quarterly

instalments of £8 each, commencing on 31st January, 1901, and the four instalments were punctually paid. On 4th December, 1901, he sold at cost price an article of the furniture on credit to John Jones for £10. These were all the transactions that occurred on this account in 1901, and, ignoring any question of Depreciation, here follows a statement of them, from which it will be seen in passing that the effect of striking the balance is to deduct the £10, proceeds of sale, from the total on the other side.

FURNITURE ACCOUNT.

		£ s. d.			£ s. d.
1901.			1901.		
Jan. 1	To Balance (brought forward from 1900)	400 0 0	Dec. 4	By John Jones for portion sold ..	10 0 0
,, 31	,, Cash, first quarterly instalment for further purchase	8 0 0	,, 31	,, Balance carried down	422 0 0
April 30	,, Cash, second quarterly instalment for further purchase ..	8 0 0			
July 31	,, Cash, third quarterly instalment for further purchase	8 0 0			
Oct. 31	,, Cash, fourth quarterly instalment for further purchase ..	8 0 0			
		£432 0 0			£432 0 0
1902.					
Jan. 1	To Balance brought down	£422 0 0			

Thomas Brown has thus paid £422 net for the furniture he has left.

Now this short statement headed Furniture Account, after first of all showing the result at the end of 1900 (£400), affords particulars of the transactions for or during the period (the year 1901) in which they took place, and would not be set out in Thomas Brown's Balance Sheet; whereas the heading, taken together with the balance only, thus: "Furniture Account, £422," states the result of the transactions, and would appear as one of the items in his Balance Sheet at 31st December, 1901, showing the position of the matter at that date, the end of a period commenced with Thomas Brown's first transaction as to furniture, whenever that may have been. This item would similarly appear in the succeeding Balance Sheets, subject to any further changes occasioned by such matters as writing off Depreciation for Wear and Tear, fresh purchases, and parting wholly or otherwise with the furniture.

And so the items one and all in a Balance Sheet are the result, at the date therein stated, of the different accounts, which are subject to

various changes by way of addition or deduction—changes that are recorded, where proper books of account are kept, in the manner shown by the foregoing "Furniture Account." This, be it said, is such an account as would appear in Thomas Brown's Ledger, wherein would be found not only the details here set out in respect of the year 1901, but also similar particulars of the transactions that resulted in the balance of £400 brought forward from 1900. In Thomas Brown's Balance Sheet at 31st December, 1900, this £400 would hold a place corresponding to that of the later balance of £422 in the Balance Sheet at 31st December, 1901.

As an arrangement of correctly shaped materials—of which, however, the settlement often demands careful and lengthy consideration—the mere formation of a Balance Sheet is a simple enough process, and for its accomplishment the existence of a set of financial books, though greatly to be desired, is by no means an essential. For the sake of illustration let us suppose that an individual, whom we will call John Jones, and who keeps no such books of account, desires at, say, 31st December, 1901,

to draw up a statement of the position of his finances. With the aid of memory and of miscellaneous documents, such as his Bank Pass Book, memoranda, unpaid accounts, receipted accounts, &c., &c., he proceeds to make out a Balance Sheet in the following manner:—By putting down on the left-hand side of a sheet of paper the debts he owes, that is to say, his Liabilities to Creditors; and on the right-hand side, all that he possesses, in other words, his Assets; then filling in the difference between the two sides so as to make the total of one equal to that of the other. Now a surplus of Assets over Liabilities to Creditors represents one's Capital, but if, on the other hand, such Liabilities be in excess of the Assets, the difference would manifestly represent a deficiency of Assets, which means insolvency, the Capital and more besides having been lost. After this explanation we may now consider the Balance Sheet prepared as above described, and showing in this case a surplus of Assets over Liabilities to Creditors amounting to £7858 10s., which has been inserted accordingly as Capital.

JOHN JONES.

Balance Sheet at 31st December, 1901.

Capital, Liabilities, &c.	£ s. d.	£ s. d.	Property, Assets, &c.	£ s. d.	£ s. d.
CREDITORS—			HOUSEHOLD FURNITURE AND EFFECTS		600 0 0
A. B., Son & Co.	15 5 4		INVESTMENTS ..		7239 10 4
C. D.	8 10 9		DEBTOR—		
E. F. & Co. ..	0 15 6		B. C. (Loan) ..		10 0 0
G. H. & Sons ..	1 6 6	25 18 1	CASH AT BANK ..		30 15 6
JOHN JONES' CAPITAL		7858 10 0	CASH IN HAND ..		4 2 3
		£7884 8 1			£7884 8 1

The meaning of this is that the combination of Assets presided over by John Jones, and amounting to £7884 8s. 1d., owes £25 18s. 1d. to Creditors, and £7858 10s. to himself; in other words, £25 18s. 1d. of the Assets belong to Creditors, and £7858 10s. to John Jones.

At 31st December, 1902, a year later, having still refrained from keeping a set of books, he prepares on the same lines another Balance Sheet, which need not be here set out, and finds that Capital now amounts to £7911 15s. 4d., an increase of £53 5s. 4d. during the year. The difference between Capital at commencement and Capital at the end of a period, if an increase, is usually what has been saved out

of the Income that has arisen during the period, though it might in whole or in part be a fresh importation of Capital pure and simple. For instance, a Legacy, or a Capital Profit, as a Profit on sale of an Investment, which is of the nature of Capital and not of Income. Had Capital decreased instead of increasing it would, needless to state, have meant a Loss made during the period; or, in case of, say, a partnership concern, possibly Capital withdrawn from the business.

There is this to be said for a Balance Sheet made up in such a manner: it is better than none at all. But if John Jones had kept a proper set of books he would not have had to depend on memory, and on papers that are liable to be mislaid, to supply particulars he required; for each item contained in the foregoing Balance Sheet would have appeared in such books as the balance or result of the account, therein detailed, to which it relates. The books would have also afforded full particulars of the increase of Capital, £53 5s. 4d., and, assuming it to have been Profit of the nature of Income, these would be details of the gross Income for the year and of the

various expenses deducted therefrom during the year, expenses that one customarily provides for out of Income, as being in the nature of Losses: that is, value expended without an Asset of any permanent worth being therewith purchased. In the absence, however, of a system of accounts, there is nothing to show how the increase of £53 5s. 4d. is made up; and this is only one out of the numerous disadvantages that arise from the neglect to keep suitable accounts—a subject, however, that hardly comes within the scope of these pages to enlarge upon.

The Balance Sheet of a Limited Company, a partnership, an institution, or any other concern, is to be looked upon as the account of an individual: that is to say, the concern must be considered as if it were one individual, as having a distinct personality and a separate existence of its own, entirely apart from the personality of the individuals who compose it. This is the commercial view, which is sufficient for all purposes except certain legal ones; and, in fact, with regard to Limited Companies and other bodies that need not here be particularised, the view is held by the Law itself.

The Balance Sheet has always two sides, separate and distinct from one another. The left-hand side is called the "Debit" or "Debtor," and the right-hand side the "Credit" or "Creditor" side. This is mentioned solely for the sake of the convenience it affords when referring to the one or the other.

Note should be taken of the headings of a statement that one desires to understand. In case of the specimen Balance Sheet herewith the Debit side is headed "Capital, Liabilities, &c.," and the Credit side, "Property, Assets, &c." Modifications of these headings are to be found in different Balance Sheets, but without altering the principle in the least. This is a matter that need not here be dwelt upon. It is referred to at a later stage.

First, with regard to Capital, Liabilities, &c.

The reader already will have seen that Capital is itself a Liability—one of a peculiar nature it is true, but still a liability, as further explained on a subsequent page. In fact, all the items on the Debit side are liabilities of various natures. Notice need not at present be taken of the "&c." at the end of this heading.

In the ordinary course a liability arises when an individual receives money, or what is reckoned as money's worth, for which that individual has not yet given an equivalent.

And thus the Debit items in a Balance Sheet are such receipts of money or money's worth as remained liabilities at date of Balance Sheet, because the individual person or individual concern, as the case may be, whose statement it is, had not yet given equal value for them or paid them off. It is not sought in the Balance Sheet to specify what proportion of these debits was received in actual cash, and how much in money's worth, though the substance in which a particular item came into the concern's hands may be indicated. But with this the reader will not ordinarily trouble himself, the material questions for him to consider being, to whom is the concern indebted for the Receipts, which the Debit side shows, and what has been done with them, as shown on the Credit side. To insure, however, a clear understanding, it is necessary to explain exactly what is meant by "money's worth."

The Receipts that appear on the Debit side of a Balance Sheet have entered into the

concern's possession, generally speaking, both partly in cash and partly in what has been considered the equivalent to cash, or money's worth—a term that includes property, goods, and other assets, and also those services whereto a value is attached, though no cash or other asset changes ownership in the rendering, all of these, though not actual money, being valued at a cash figure, and so treated in the accounts. Some explanation is necessary of the reference to services. An instance that may be given is the item "Workmen's Wages Unpaid," a debit often arising for inclusion in Balance Sheets. The workmen have performed services to the concern, that is, they have earned their wages, from the last settlement to date of Balance Sheet, but they will not be paid until next pay-day, which falls subsequently to that date; meanwhile the concern is in the position of having received the workmen's services without having yet made them a return therefor. To these services, needless to say, is attributable a cash value or money's worth, the amount of which appears on the Debit side of the Balance Sheet as a receipt—a receipt of the services—

and as a liability to the workmen. This, of course, is not the only instance of the kind of thing referred to, but it serves to illustrate the principle, which is that of Hiring. A workman hires out his labour; an investor in Stocks and Shares hires out his money; a property owner hires out his houses or other properties (by letting them to tenants for rent). And thus we may find recorded in the Balance Sheet the receipt of services that lay not in transferring to the concern the absolute ownership of cash or other asset, but in the performance of some act of value calculated by the concern to operate in the acquisition of assets.

The foregoing remarks as to the shape in which Receipts come into the hands of a concern may obviate misapprehension, but there is no need, as already expressed, to go into such matters deeply in order to understand a Balance Sheet, for which purpose the all-important is to recognise the Debit side as showing on a monetary basis those Receipts, of some kind or another, that still are Liabilities at date of Balance Sheet, and the Credit side as showing where the said Receipts have gone to—by what they are represented—what the concern's

Possessions are at date of Balance Sheet. It will thus be seen that the total on one side of the Balance Sheet must always be of the same amount as the total on the other side.

The balance of the Profit and Loss Account, if Profit, a Receipt, naturally appears on the Debit side of the Balance Sheet; and in case of private concerns it is, subject, of course, to partners' drawings, added to Capital, being Profit saved and thereby capitalised. Limited Companies, however, keep Capital and Profit and Loss Account entirely apart in their accounts, in view, for one reason, of the Law's requirements. The Balance Profit, available for dividend or other appropriation, is thus kept apart in the specimen Balance Sheet, as will be seen in due course.

And now with regard to Property, Assets, &c., on the Credit side.

For the present disregard the "&c.," which is explained on a subsequent page. Property whereto any value attaches is obviously an Asset.

On first acquiring Receipts a concern naturally proceeds to expend them in the acquisition of Possessions, with a view to making

Profits and so increasing its Receipts and, at the same time, Possessions, for the benefit of its members; the concern, in other words, commences business. Profits however are, unfortunately, not the invariable rule. Sometimes Losses result: that is to say, Receipts to a greater or less extent are lost. Losses made during the period from one Balance Sheet to another operate in reduction of a balance of former Profits, if there is one, that has not otherwise been parted with, supposing, of course, the Losses to be the smaller amount, for part of the former Profits have been lost; there is thus a net balance of Profits left over that would appear on the Debit side of the Balance Sheet; but if there are no such earlier Profits from which to deduct the Losses, or should the latter be in excess, then Capital has been lost, and the balance of Profit and Loss Account (a balance Loss) would, in case of a private individual or firm, be deducted from Capital on the Debit side of the Balance Sheet. But such a deduction is not permissible to be made by Limited Companies, in whose Balance Sheets the item would appear on the Credit side, showing the balance of Losses.

There is no violation of the stated principle in any of these respects, as one can readily see, on reflection, that the Credit side shows what has become of the Receipts opposite.

Every item on the Credit side of a Balance Sheet, if not an Asset, must be a Loss. There are Assets, however, that may be worth more or less than the figure at which they are stated, as elsewhere touched upon.

The reader is now asked to refer to the specimen Balance Sheet that accompanies these explanations, and which has been made out on the lines of the form given in a Schedule to The Companies Act, 1862. It was thought desirable to frame the document as for a Company Limited by Shares (the class of Limited Companies contemplated throughout these pages), for a reason already mentioned; but so far as accountancy is concerned there is no difference in principle between the Balance Sheet of a Limited Company and that of any other concern or individual. There is an essential difference as to detail, the legal feature already referred to, which is that a Limited Company must not reduce the amount of its Share Capital, or increase it

except by the issue of further Shares within the limits originally authorised, without going through some more or less troublesome legal requirements; whilst an ordinary partnership or association may add Profits saved to its Capital, thereby increasing the latter, or may reduce its Capital, subject only to the partnership agreement or the regulations governing the individual concern. These, however, are methods of procedure that do not in the least affect the principle of the Balance Sheet as a statement of account.

Before an explanation of the items contained in the specimen Balance Sheet is entered upon, it may be stated that the figures in the outer columns, those that are totalled, show the net position of each account at date of Balance Sheet, whilst additional information appears in the inner columns.

CHAPTER II.

EXPLANATION OF DEBIT ITEMS IN THE SPECIMEN BALANCE SHEET.

THE various items on the Debit side headed "Capital, Liabilities, &c.," may be explained as follows:—

CAPITAL, £5200.

The particulars of this item show how many Shares the Company is entitled to issue—viz., 10,000 Shares. There is also shown that the nominal value of the Shares is £1 each. The nominal value is the amount of the Share as expressed in the Company's Memorandum of Association, and this usually is the figure that the Shareholders became liable to pay, as and when required, to the Company for their Shares at the time of its commencement. The actual value is generally a very different thing, being the amount, after the Shareholders have acquired

their Shares, at which one Shareholder can sell to another or to an outsider, and this may be more or less than the nominal value, depending, of course, upon the market price of the Shares at the date of their changing hands. The nominal value, therefore, directly affects the Company's pocket, whilst the actual value does not. Subject to a certain qualification, ordinary applicants for Shares in a Limited Company cannot obtain them from the Company for less than the nominal value. The Law forbids it. Sometimes, on the other hand, Shares are issued at a premium—that is, an amount per Share over and above the nominal value.

This item further shows that the Company has issued 7000 Shares and called up or demanded from the Shareholders fifteen shillings per Share. It also shows in the inner money column the amount, £5250, that has fallen due to the Company from the Shareholders in respect of the Shares issued to them. From this figure is deducted the item, Calls in Arrear, £50, which is an amount, part of the £5250, that some Shareholder or Shareholders have not yet paid, leaving the sum of £5200, Capital that has been actually received.

The item, Capital, £5200, indicates, therefore, that the Company has received the same from the Shareholders, and that it is a Liability due to them from the Company.

Now it has previously been stated that Capital is a Liability, though one of a peculiar nature. The Shareholders are virtually partners (with limited liability) in the Company. It is formed of Shareholders. They are the parts that make up the Company as a whole. The Company having received the Capital from the Shareholders, without giving them an equivalent in return, therefore owes the amount of the Capital to them. But they cannot get it back unless under exceptional circumstances. If the Company be wound up, anything left over after payment of Creditors must be handed over to the Shareholders in the proportions in which they are entitled to the funds of the Company; and should a Company at any time find itself with too much Capital—a thing that does not frequently happen—it may, after observing certain formalities and with the necessary sanction, return the surplus Capital in the proper proportions. In this wise Capital is a Liability, and differs from ordinary Liabilities.

Briefly, Capital amounts to being almost a nominal Liability, that is not payable under ordinary circumstances to the Shareholders, but for which the Company is liable to account to them, this duty being performed by means of the Balance Sheet. You may only pay off Capital under certain peculiar circumstances, whilst you must pay ordinary Liabilities under usual and ordinary circumstances, assuming, of course, that you have the wherewithal to do these things.

The following information may be derived from this the first item in the Balance Sheet :—

That under its existing regulations the Company is entitled to issue	10,000	£1 Shares
That the Company has actually issued ..	7,000	,,
Leaving unissued	3,000	,,

That the Company, having issued 7,000 Shares of £1 each, has called up 15s. per Share	£5,250 0 0
That some of the Shareholders (or one of them) have not paid in full the amount of Calls made on them, and still owe to the Company the sum of	50 0 0
That by deducting this £50, Calls Unpaid, from the full amount, £5,250, of Calls made, we arrive at the amount of Capital actually received from the Shareholders by means of these Calls	£5,200 0 0

The Company is of course entitled to demand payment from Shareholders whose Calls are in arrear; in default of payment their Shares may be forfeited to the Company where the power of forfeiture is provided for.

That there having been issued 7,000 Shares, of £1 each, at par	£7,000 0 0
And there having been called up only 15s. per Share	5,250 0 0
The Company is entitled to call up the difference, the 5s. per Share yet uncalled	£1,750 0 0

The term "at par," as used above, means that these £1 Shares were issued at £1, and not at a premium.

Shares are said to stand at—to be worth—par, when their actual or market value is of the same amount as the sum paid up on them.

With regard to Calls, provision may be found that so much per Share will not be called up before a fixed date; and there are Companies whose regulations make it obligatory for a certain amount per Share to remain uncalled in the ordinary course of events, so as to provide a fund to fall back upon in the emergency of Liquidation.

That (taking for granted that applicants for the Shares would readily come forward), were the Company to issue at par those 3,000 Shares yet unissued as shown above, and call them up in full	£3,000 0 0
As well as making the further Call of 5s. per Share on the 7,000 Shares that already have been issued, as shown above ..	1,750 0 0
Further Capital would come into the Company's possession, amounting to ..	£4,750 0 0

Where Shares are issued as fully or partly paid in consideration of some value, other

than cash, handed over to the Company by the Shareholders concerned, the position is in principle as if the Company had received actual cash and purchased therewith the said value, which in either event naturally appears on the Assets side of the Balance Sheet, with of course Capital on the Debit side.

The Capital shown in the specimen Balance Sheet is, it will have been seen, all in one class of Shares, but, as the reader is no doubt aware, there are several varieties of Shares issued by Limited Companies, an explanation of which is hardly within our present scope. All, however, are Capital, and the distinctions between them, so far as accounts are concerned, may be said to affect nothing more than the proportions and priorities to be observed as to dividends out of profits, and, in the event of a Winding-up or Liquidation, as to Capital. With some Companies the Capital is under the classification of "Stock," which must not be confused with the Asset, Stock on Hand, dealt with in due course, that appears on the Credit side, and consists of the stores in hand of goods used in the business.

FORFEITED SHARES, £25.

Besides the Shares issued, as shown in the particulars of the preceding item, Capital, there were some other Shares issued at the same time and in the ordinary course to certain Shareholders (or, as the case may be, to one Shareholder) who, it since turned out, could not or would not pay up all the Calls made on them in respect of these Shares, and who paid only a part—this £25. Under such circumstances these particular Shares, as well as the sum of £25 paid on them, were forfeited, after certain formalities had been gone through; whereupon the Shares themselves became unissued, and now form part of the unissued Share Capital of the Company; the £25 became forfeited to the Company and ceased to represent Share Capital; and the Shareholders who paid the £25 ceased to be Shareholders and lost all their rights to that sum, together with all other appurtenant interest or rights in the Company.

This item, in fact, has ceased to be a Liability to the individuals who, prior to the forfeiture, were Shareholders, and from whom

the Company received the amount, £25; it has become a Liability to the Shareholders generally, though, like Capital, it cannot be paid to them unless under exceptional circumstances. It may be used as a Reserve, applicable for anything in the nature of Capital expenditure, but not for payment of dividend or of expenses strictly chargeable against the Income.

The number of Shares forfeited should appear in the first Balance Sheet after forfeiture, but not necessarily in the succeeding Balance Sheets.

FIRST MORTGAGE DEBENTURES, £4000.

As already stated, Shareholders, with the provision that their liability is limited, are the partners in a Limited Company, and share the Profits; if there are no Profits the Shareholders get no dividend. Mortgage Debenture Holders are not partners in the Company, in any shape or form, nor do they share the Profits, but, in priority to Shareholders, they get for the use of their money a fixed rate of interest, which the Company must pay, even where there are no Profits, if there are Capital funds available.

They are, in fact, Creditors who have lent money to the Company, receiving in exchange the documents called Mortgage Debentures, which, together as a rule, constitute a Mortgage of the whole or part of the Company's Possessions, each Mortgage Debenture Holder, in return for the money he has lent, having thus a share of a Mortgage on Assets of the Company, and taking a fixed rate of interest on his loan—a very different position from that of the Shareholder.

The term "Debenture" is also applied to a document which is not in any degree a Mortgage, but merely amounts to being a promise to repay, bearing interest, and issued by the Company to the lender. The Mortgage Debenture is naturally the more satisfactory and the more usual.

All Debenture Holders, whether of Mortgage Debentures or otherwise, are Creditors and not Shareholders.

Unlike Shares, Debentures may be issued to the public below the face value: that is, at a discount.

We may gather from this item, "First Mortgage Debentures, £4000," of which the

issue is taken as made at face value, that loans have been received to the extent of that amount, and, if the Company go to the wall, the Debenture Holders would be entitled to repayment in full out of the Assets covered by the Debentures before any Mortgages of a lower standing and the general body of Creditors, Shareholders coming last of all. The footing upon which such charges are situated as between themselves depends on the conditions of issue and their legal significance. There are cases where charges can be created over the heads of the holders of existing ones.

From the particulars given it appears that forty of the documents, of £100 each, have been issued to the Debenture Holders, and that the latter are entitled to be paid interest at a fixed rate of four per cent. per annum.

The item we are dealing with thus indicates the persons to whom the Liability is due, but, though a Liability due from the Company to the Debenture Holders, it is not payable to them until such time—perhaps several years hence—as may have been fixed by the terms of the Debentures; or until a specified notice is given;

or the terms may provide that the moneys are not repayable except in the event of the Company's failing to duly pay the interest, or going into Liquidation.

Loans received on Debentures of any description are Loan Capital of the Company.

MORTGAGE, £1000.

This item, similar in principle to the preceding one, records a loan of £1000, for which the lender has been given an ordinary Mortgage on Possessions of the Company.

It shows there is a Liability of that amount due from the Company, and indicates the Creditor to whom it is due: viz., the Mortgagee who lent the £1000 to the concern. This Liability, as in the case of the last item, is not a debt payable at any time, but is governed by the conditions attaching to the Mortgage.

Like Mortgage Debenture Holders, a Mortgagee is a secured Creditor, holding a charge on property of the concern and so enjoying prior rights as to repayment. The item appears in the specimen Balance Sheet as

a charge not in precedence to the Debentures but either in the same rank or subordinate.

Loans received by the Company on Mortgage are Loan Capital.

SUNDRY CREDITORS, £682 4s. 6d.

From this item it appears that something has been received by the Company from various quarters, say goods for the most part, required in a business. This "something received" is stated at a monetary figure, £682 4s. 6d., the aggregate amount charged for the goods or other value by those who supplied the Company therewith, and who are unpaid, *i.e.*, Creditors at date of Balance Sheet. The item consists, like other Liabilities, of receipts of some kind that the concern has had, and for which, at date of Balance Sheet, it has not so far paid or given an equivalent; but in this case ordinary business debts, unsecured, payable in the general course.

BILLS PAYABLE, £150.

This simply means Creditors for £150, to whom, instead of paying money, the Company has given Bills for that amount, payable by the Company at some future date as stated

in the Bills. These Creditors, at date of Balance Sheet, are still unpaid, having received not cash but only the Bills—written documents which convey the Company's promise to pay the money at a future time; but it is proper to show distinctly in the Balance Sheet the Creditors to whom such documents have been given entirely separate from Creditors who are not holders of Bills, and this is shown in the manner stated. The title, "Bills Payable," is thus a shorter form of saying "Creditors holding Bills Payable."

This item, needless to say, is in addition to the preceding one, Sundry Creditors, £682 4s. 6d., and (ignoring any question of interest which might tend to confuse), had the Bills Payable not been given, the £150, if still unpaid, would be added to and form part of that item, which would thus be increased to £832 4s. 6d., unless, of course, the holders of these Bills are in respect of debts that should be shown separately in any event.

DEBENTURE INTEREST UNPAID, £75 6s. 8d.

As previously stated, the Debenture Holders have made a loan to the Company, of which loan the amount is entered in the Balance Sheet

as received from and as a Liability to the Debenture Holders. But the inducement for them to lend the money to the Company was the fact that they were to receive interest thereon, at the fixed rate stated in the Debentures, in return for the services to be rendered to the Company by means of this loan.

And so, though the amount of the loan itself appears, as we have seen, in the Balance Sheet, there is something more that, if unpaid, must also appear: viz., Debenture Interest. This item then, £75 6s. 8d., is the amount of the Debenture Interest fallen due but unpaid at date of Balance Sheet, and is the value at which those services received from the Debenture Holders, and below explained, are placed.

In principle, services of two distinct kinds have been performed, though the first is of no use without the second. The first service lies in the Debenture Holders placing the amount of the loan, £4000, in the possession of the Company, whereupon that sum at once becomes a receipt of the Company's and a Liability to the Debenture Holders, and so it is entered in the Balance Sheet. The second

service lies in the Debenture Holders allowing the loan to remain in the Company's possession, for the Company's use, during the length of time embraced by the Mortgage Debentures, and this service is re-paid by the Company's paying to the Debenture Holders interest at the rate, in this instance, of four per cent. per annum on the amount of their loan.

Debenture Interest is usually paid half-yearly at dates that are fixed by the terms of the Debentures. In making out the specimen Balance Sheet, the periods during which the Debenture Interest becomes due have been taken to be the half-years ending 30th June and 31st December; and the dates on which it is payable, 1st July and 1st January, in each year. The item, Debenture Interest Unpaid, £75 6s. 8d., is the half-year's interest to 31st December, 1901, that is payable the next day, 1st January, 1902, and so, at date of Balance Sheet, it is not yet paid.

We may thus gather from this item that services, valued at £75 6s. 8d., have been received by the Company from the Debenture Holders, in that the amount of their loan continued in the Company's use for the half-year

ending 31st December, 1901, services that, at date of Balance Sheet, the Company had not yet paid for, and of which the amount, £75 6s. 8d., is therefore a Liability.

It is clear from the Balance Sheet that there are no arrears of Debenture Interest. If, for example, the interest for the previous half-year, to 30th June, 1901, were still owing, it would of course be added to and form part of this item, Debenture Interest Unpaid, which, instead of being £75 6s. 8d., would naturally be about doubled.

As it is, the item is arrived at as follows :—

	£	s.	d.
Mortgage Debentures, £4000 @ 4 % per annum	160	0	0
One half year's interest is therefore one half of £160 ..	80	0	0
Deduct Income Tax at 1s. 2d. in the £	4	13	4
Leaving the amount due to Debenture Holders	£75	6	8

The Company should always deduct Income Tax, for it is the Company that will be called upon to pay it to the Income Tax Collector.

This £75 6s. 8d. has been charged on the expenses side of the (detailed) Profit and Loss Account in the Ledger, being thus deducted from the Profits of which the balance for the year, £700, appears in the specimen Balance Sheet after such deduction, which, however,

though without affecting the result, is commonly shown; for this expenditure, being interest on Capital, is in the nature of a distribution of Profit, if Profit there be. If the concern were making Losses instead of Profits, it need hardly be said that the effect of charging the item against Profit and Loss Account would be to increase the Losses; whilst, Debenture Holders being Creditors and not Shareholders, the services would none the less be owed for, the item, Debenture Interest Unpaid, consequently appearing in the Balance Sheet just as it does now.

On a former page it is stated that this class of item records the receipt of services rendered by way of hiring out something to the concern, the "something hired" in the present instance being money. It depends upon the concern and its opportunities as to whether or not the services of hiring are attended by the acquisition of Assets to represent the value attached to them.

WORKMEN'S WAGES UNPAID, £65 16s. 8d.

Such an item has already been dealt with. It may, however, here be stated that services valued at £65 16s. 8d. have been received by

the Company from the Workmen, for the latter have to this extent earned their wages from the day up to which they were last paid to date of Balance Sheet, and—the Company at that date having not yet paid them off—the item remains a Liability, due, as it states, to the Workmen. It is, however, to be discharged on the next pay day, after date of Balance Sheet.

Just as in case of the preceding item we have seen that the amount of Debenture Interest Unpaid is what is owing by the Company for "hire" of the Debenture Holders' money, so the item now under consideration informs us of the liability due to the employees for their personal hire as Workmen.

UNCLAIMED DIVIDENDS, £9 9s. 7d.
RESERVE FUND, £100.

For the sake of convenience these two items will be dealt with after treatment of the next item, Profit and Loss Account.

PROFIT AND LOSS ACCOUNT, £507 11s. 8d.

The first portion of the details of this item, down to and including the figure, £53 10s., is sometimes headed "Revenue Account," and

the remainder "Profit and Loss Account." Sometimes the whole of it is headed "Revenue Account." But it does not much matter what the heading is, so long as the details show plainly enough the balance of Profits at the beginning of the period, and the net Profits for the period, together with their disposal.

The £507 11s. 8d., net balance of Profit and Loss Account at 31st December, 1901, is Profit; this is clear from the fact of the item being on the Debit side of the Balance Sheet—the side that shows the concern's Receipts of some kind or other—and Profits are, of course, receipts of cash or other asset. Should, however, the net balance of Profit and Loss Account appear in a Balance Sheet on the Credit, or Expenditure side, instead of on the Debit, or Receipt side, it would, as already explained, mean a Loss. For if at date of Balance Sheet there be a balance Profit, the concern must have received it in some shape or form, and, on the other hand, should there be a balance Loss, the concern must have expended the amount thereof and lost it.

The item, £507 11s. 8d., a receipt of the Company's, is the balance Profit remaining

undisposed of at date of Balance Sheet. Its particulars show that—

1. The Balance Profit undisposed of at the end of the previous year, 31st December, 1900, and carried forward to the Balance Sheet we are now dealing with, was £300 10s., a sum that would occupy the same place in the Balance Sheet at 31st December, 1900, as the £507 11s. 8d. occupies in the Balance Sheet at 31st December, 1901.
2. A dividend, amounting to £247, was paid to the Shareholders on 1st February, 1901; this dividend, being paid on account of the previous year, disposed of part of the balance Profits brought forward, £300 10s., and we therefore deduct the one from the other, the balance of Profits left undisposed of at this point being £53 10s., as the figures show.
3. To this £53 10s. is now added £700, the net Profit for the year ending 31st December, 1901, the balance left after deduction from the gross Profit of

all expenses and charges payable out of Income in the usual course, including Debenture and Mortgage interest.

4. The balance Profits, £753 10s., resulting from the said addition, is reduced by a further dividend—an intermediate one—paid, on account of the current year, to the Shareholders on 3rd August, 1901, to the extent of £245 18s. 4d., which leaves the sum of £507 11s. 8d. undisposed of at the end of the year.

But it does not by any means follow that, because there has been a net receipt of Profit, £507 11s. 8d., the Company at date of Balance Sheet has it in cash. These Receipts of the Company's, as already explained, are not in cash alone, but are partly in money and partly in what has been esteemed as money's worth; and moreover, some of the Profits may, for sound financial reasons, have been used in the business. If there is not sufficient cash at Bank and in hand at date of Balance Sheet to equal the balance Profits at that date, it necessarily follows that (at least) any shortage

is represented *somewhere* on the Credit side amongst the items other than cash at Bank or in hand.

This may be made more clear in the following manner:—

On the Debit side of the Balance Sheet is a balance Profit of ..		£507 11 8
On the Credit side are:—		
Cash balance at Bank	£388 16 6	
Cash balance in hand	24 0 10	
Which added together make a Cash total of		412 17 4
By deducting from the balance Profit the total Cash, a balance Profit is left amounting to		£94 14 4

Now as the totals of both sides of the Balance Sheet are of the same amount, (at least) this sum, £94 14s. 4d., not being in cash, must of necessity be represented somewhere or other amongst the remaining items on the Credit side. This is merely to illustrate the idea, but it must be remembered that, strictly speaking, one must not as a rule pick out an item in the Balance Sheet and assume as a matter of course that it is represented by one or more selected items or part thereof on the other side; for the debit items, as a whole, are represented by the credit items,

as a whole, and it is impossible without keeping them all in view to judge which represents which. There are exceptional cases where this can clearly be done, and an item on one side "ear-marked" or identified as representing an item on the other. This happens, to give a familiar instance, in case of a Reserve Fund invested in Securities outside the business, when the Reserve appearing on the Debit side of the Balance Sheet would be represented by the Investment Account on the Credit side.

The particulars contained in a Balance Sheet may of course be reduced, for one's personal information, into a smaller compass by summarising items of the same class on either side, when the resulting items, forming a condensed Balance Sheet, may be taken judiciously against one another, debits against credits.

This item, Profit and Loss Account, £507 11s. 8d., being on the Debit side of the Balance Sheet, is, of course, a Liability, though another instance exhibiting peculiar features. Now there has been Capital received from the Shareholders — a transaction that is recorded in the first entry on the Debit

side of the Balance Sheet. The Company has also received a second service from the Shareholders by the latter having allowed their Capital to remain in the Company's use with a view to the production of Profits, and for the performance of this second service the Shareholders' inducement was the expectation of having Profits at their disposal, but with the risk of going unrewarded if there are no Profits. Whilst Profits are absent the said further service has proved of no value, and Profit and Loss Account is not afforded a place as a Receipt on the Debit side of the Balance Sheet. In the case, however, under our notice, this account, presenting an available balance of £507 11s. 8d., records the receipt of such further service, Profits being received on the Shareholders' account and by virtue of the use of their Capital; and so, in whatever shape Profits enter the Company's possession, whether in cash or its deemed equivalent, they are derived from the second service of the Shareholders as above described.

The balance of Profit and Loss Account, £507 11s. 8d., besides being a receipt of the Company's, is thus a Liability due to the

Shareholders, but of this peculiar nature: that it is not as a matter of course actually payable to them. Under such conditions as may be imposed by the Articles of Association they may direct that the whole or part of these Profits be paid to themselves in dividend, or kept in hand, or used in meeting expenditure such as would not otherwise be provided for out of Income: in short, a Company's net Profits are at the Shareholders' disposal. As already stated, we have proceeded on the basis of one class of Shares only; the destination of a concern's Profits, where there are priorities, as Preference Shares, is naturally affected by the rights attaching thereto. The Articles contain, as a rule, provision with regard to the Shareholders' General Meeting, which must be held at least once in the twelve months; and at such Annual Meeting—taking place after the close of the financial year—the balance Profit is disposed of. The Directors, however, may be found empowered to declare during the year an interim or intermediate dividend, should circumstances so warrant, without having to obtain the sanction of a General Meeting of Shareholders.

The amounts of the two dividends deducted from the Profits in the specimen Balance Sheet—£247 and £245 18s. 4d.—are arrived at in the following manner :—Ten per cent. per annum on the Capital received, £5200, is the sum of £520; one half of this, £260, is therefore the gross amount of dividend for the half-year; and £260 less Income Tax at one shilling in the pound in the first, and one shilling and a penny in the second case (the rates of Tax prevailing in the respective periods), affords the above result.

UNCLAIMED DIVIDENDS, £9 9s. 7d.

There may be thought to exist some sort of contradiction regarding this item in the Balance Sheet. Under the heading, Profit and Loss Account, is shown that two dividends were paid during 1901, and partly, let us say, in the one and partly also in the other, is included the £9 9s. 7d. which the Balance Sheet elsewhere states to be the amount of Unclaimed, *i.e.*, Unpaid Dividends at the end of the year. But the explanation is this:—The two sums, £247 and £245 18s. 4d., were set aside out of Profits for payment of

dividends which, to all intents and purposes, were paid as stated on 1st February and 3rd August, 1901, respectively, for on those dates the Company sent out to the Shareholders all the dividend warrants, that is, cheques on the Company's Bankers for the various amounts, due to the Shareholders on their respective holdings of Shares, that in total make up those two dividends of £247 and £245 18s. 4d. But at 31st December, 1901, a portion of the dividend warrants, amounting to £9 9s. 7d., had not been presented by the Shareholder (or Shareholders, as the case may be) entitled to do so to the Company's Bankers for payment; such dividends are consequently unclaimed and unpaid at that date, thus remaining Liabilities as shown in the Balance Sheet. The position is that the amounts, Liabilities to the Shareholders, set aside out of Profits for dividend, have not been subjected to deduction so far as this £9 9s. 7d. is concerned; nor has the Cash at Bank. The same result, arithmetically, would be arrived at by striking out of the Balance Sheet the item "Unclaimed Dividends, £9 9s. 7d.," and, instead of stating the dividends in full at £247

and £245 18s. 4d., by substituting for those figures the dividend totals actually paid by the Company's Bankers up to and including 31st December, 1901. For this purpose, however, it will simplify matters, without affecting the result, to consider these Unclaimed Dividends, £9 9s. 7d., to be wholly in respect of the second dividend of £245 18s. 4d.; and so:—

Full amount of dividend warrants sent out on 3rd August, 1901	£245	18	4
Less Unclaimed Dividends at 31st December, 1901	9	9	7
Leaving the amount actually paid by Company's Bankers	£236	8	9

On this basis, instead of £245 18s. 4d., £236 8s. 9d. would be the figure to be deducted from the £753 10s. shown under the heading of Profit and Loss Account in the Balance Sheet.

And so, from the amount	£753	10	0				
Deduct the above figure ..	236	8	9				
Leaving the net balance of Profit and Loss Account	£517	1	3	instead of	£507	11	8

But it can readily be shown that this would be quite wrong in principle. What we have done has had the effect of taking out the £9 9s. 7d. in the one place and putting it in

again in another. Although we have struck it out as Unclaimed Dividends it has become added to the net balance of Profit and Loss Account, for:—

Net balance of Profit and Loss Account per Balance Sheet	£507	11	8
Add Unclaimed Dividends	9	9	7
Leaving the figure arrived at as above shown ..	£517	1	3

And this is where it would be wrong. Unclaimed Dividends are a Liability to a limited number, to one or to a few of the Shareholders, whilst the net balance of Profit and Loss Account is a Liability to the general body of Shareholders and at their disposal. It should therefore not be confused in any way with Unclaimed Dividends, which are not at their disposal, and will not revert to the Company—at all events until after a considerable lapse of time. It would thus be inaccurate and misleading to include these two items in one amount; they must be stated separately and distinctly as in the specimen Balance Sheet.

The particulars as to Unclaimed Dividends and Profit and Loss Account might, it is true, but without any necessity, be set forth in the

Balance Sheet with the following additions and modifications, the result, as will be observed, remaining exactly the same:—

Unclaimed Dividends—		
Amount set aside out of Profits, as below stated, for Dividend:		
For the half year ending 31st December, 1900 ..	£247 0 0	
For the half year ending 30th June, 1901	£245 18 4	
	£492 18 4	
Less total amounts of Dividend Warrants presented to the Bankers for payment and cashed by them	£483 8 9	
		£9 9 7
Profit and Loss Account—		
Balance at 31st December, 1900, as per last Balance Sheet	£300 10 0	
Less amount set aside for Dividend @ 10 % per annum for the half year ending 31st December, 1900	£247 0 0	
	£53 10 0	
Add Balance Profit for the year ending 31st December, 1901 ..	£700 0 0	
	£753 10 0	
Less amount set aside for Dividend @ 10 % per annum for the half year ending 30th June, 1901 ..	£245 18 4	
		£507 11 8

RESERVE FUND, £100.

The title "Reserve Fund," as used on the Debit side of the Balance Sheet, may be taken to be the same thing as "Reserve Account" or "Reserve," these being interchangeable

terms so far as need concern the novice. The item we are now considering is Profit set apart in one or more years and has thus once formed portion of the balance of Profit and Loss Account. That is to say, if this £100 had not been transferred or set aside out of Profits, the latter, the net balance of Profit and Loss Account, would have appeared as so much the larger in amount. It has therefore been received in the same shape as the Profits themselves—in cash or other asset deemed the equivalent to cash.

The purpose for which the Reserve is created should, as a rule, be stated in the Balance Sheet. It is not so in the specimen Balance Sheet, because the item we are dealing with has therein been given as a general illustration; for all true Reserves are alike in principle though formed for different requirements, and their object is always the provision against some expenditure or loss that may —or will—befall to be coped or dealt with in the future.

A Reserve Fund may be found to have been invested outside the business, when the Investments representing it will appear on the Credit

side of the Balance Sheet. If not invested outside the business the amount must necessarily have been employed therein, the Reserve thus being represented somewhere amongst the items on the Credit side.

The Reserve is a Liability to the Shareholders, but of this peculiar nature: that having been laid aside out of Profits it is not intended as a sum due to be paid to the Shareholders, but to fulfil the purposes for which they created it; these purposes, as we may presume, being for the Company's benefit, and therefore for benefit of the Shareholders. In case, however, of a Reserve Fund created in good times for the purpose of keeping up the dividends should less favourable times appear, it is contemplated that the whole or part of the Reserve may at some time or other be paid to them.

So much at the present for Reserves that have their origin in Income; there are some that originate from Capital. Profit may accrue to a Company, not an Income Profit, but a Capital Profit, in the nature of an increase of Capital. As Limited Companies cannot, by a stroke of the pen, increase their Capital, even though in principle it has grown larger than the amount of

Capital stated in the Balance Sheet, such an increase should be treated as a Reserve. An item of this kind in the Balance Sheet is not always stated in direct terms to be a Reserve, it being considered that the title showing the origin of the item is a sufficient indication of its nature. Instances of Capital Profits are:—Forfeited Shares, Premium on Shares, Profit on sale of business premises, land, patents, or other Assets of which purchasing to sell again was not in the course of the Company's ordinary business. Reserve Funds of a Capital origin are properly available for any purpose to which Capital itself may be devoted, and, be it only for discretion's sake, not for payment of dividends.

In view of the misleading way in which Reserve Accounts have at times been treated, let the reader particularly note:—Whilst the Reserve appearing on the Debit side may be viewed as having formerly been received in some shape or other, the questions are: Has it been retained? What is the position now? And even if it appears as represented by specific Investments, the Reserve itself may in effect have ceased to exist; for should an item on the

Assets side be worth less than the figure at which in the outer column it is stated, to the extent, say, of the same amount as that of the Reserve opposite, such Reserve may in prudence be considered no longer existent, any value, that on the Credit side had represented it, taking the place made vacant by the said shrinkage in the Credit item.

Here closes the explanation of the Debit side of the Balance Sheet whereon are set forth the Receipts that the concern has had without having yet given an equivalent, and that are therefore Liabilities, at date of Balance Sheet, thus showing to whom the Possessions, stated on the other side, belong.

CHAPTER III.

EXPLANATION OF CREDIT ITEMS IN THE SPECIMEN BALANCE SHEET.

THE various items on the Credit side of the Balance Sheet, headed "Property, Assets, &c.," are now to be considered, premising that a concern may be looked upon as a kind of trustee holding the Possessions shown on the Credit side in trust for the persons indicated on the Debit side. And, be it remembered, credits as well as debits are stated in the position at which they stood on the date of Balance Sheet.

FREEHOLD LAND, £1500.

The value stated, in this case £1500, is usually the amount that the Company paid for the property, and in consequence the Asset may be worth more or less than the figure at which it is stated in a Balance Sheet; for it has possibly gone up in value or appreciated; it may

have gone down in value or depreciated. This subject is one of many that cannot conveniently be dealt with in all their bearings within the restricted space and aims of a work of this description, but the following remarks should not be omitted. If an Asset is worth more than the amount shown in the Balance Sheet the concern is at least on the safe side; and on the other hand, when a fall in value of Freehold Land does take place, it may be entirely in the nature of a fluctuation; differing from the Depreciation in respect of a purchase of Leasehold Land—an Asset that wastes away or depreciates year by year until the Lease has run out—when it is worth nothing to the Lessee because of its reverting to the owner of the Land who granted the Lease; differing also from the Depreciation of Machinery, for Machinery wears out, and, apart from Wear and Tear, may depreciate through becoming out of date.

The wasting of Leasehold Property, the Wear and Tear of Plant and Machinery, and the like, are anticipated when the Assets are purchased, and so can be regularly provided for year by year, whilst Freehold Land may never depreciate.

Considerable inconvenience would be caused were fluctuations in the value of Freehold Land, or of other fixed Assets, to be continually given effect to in the Balance Sheet and accounts; but any fall in value of a serious nature should, assuming it has not been written off out of Profits or Reserve, be so pointed out on the face of the Balance Sheet as not to conceal the diminished worth of the Assets. Fixed or permanent Assets, it may be mentioned, are such as are acquired to keep for the purpose of carrying on the business; whilst the composition of floating or circulating Assets is continually changing; and, broadly speaking, provision for Depreciation, essential in case of the latter class, has been considered as not obligatory, though highly desirable, with regard to the former.

	£	s.	d.	£	s.	d.
FREEHOLD BUILDINGS ...	3000	0	0			
Less DEPRECIATION ...	150	0	0			
				2850	0	0

These are Buildings that stand on the Freehold Land. The figure at which they appear in a Balance Sheet is usually the amount paid for them, subject to deduction from year to year of Depreciation. The instance before

us shows the balance of this account at the end of last year, £3000, less the amount written off for 1901, £150, leaving the balance at the end of this year, £2850.

Buildings naturally "wear out" in a lapse of years. The rate to be deducted each year to cover this "wearing out" or Depreciation depends on circumstances—as the quality of building, and the purposes for which the premises are used—and is thus an Estimate. Sometimes the Buildings, stated in the Balance Sheet at cost price without any deduction for Depreciation, are claimed to be maintained at that value by means of the Repairs and Renewals expended out of Profits.

Enquiry is of course invited where there appears to be no provision for Depreciation of this or any other Asset with a similar propensity.

	£ s. d.	£ s. d.
LEASEHOLD BUILDINGS...	3600 0 0	
Less DEPRECIATION ...	327 5 6	
		3272 14 6

These are Buildings, together with the land on which they are erected, whereof a Lease has been purchased.

Like Freehold Buildings, they are shown in the Balance Sheet usually at cost price, subject to reduction by annual Depreciation, based in this case on the length of the Lease. Let us now suppose that the Leasehold is found stated in the Balance Sheet without any deduction for Depreciation having been made, whilst on the Debit side appears that class of Reserve called Sinking Fund, formed out of Profits by setting aside an amount on exact lines each year so that when the Lease expires the Fund, wherein interest has been taken into account, will amount to the sum for which that Asset was purchased; the Sinking Fund should generally be invested outside the business, the investments representing it appearing amongst the Assets on the Credit side of the Balance Sheet. The object of this is, of course, to reserve out of Profits a precisely computed amount, and to put it away in a safe place from time to time, so that when the Lease has run out the Company will have realisable investments worth the sum paid for it; a replacement out of Income of the lost Capital, in an available form. But the question of non-existent Reserves is involved

in this connection; and the proper course is to deduct the Sinking Fund as Depreciation from the wasting Asset on the Credit side, and not under such conditions to place it as a Reserve on the Debit.

The same objection would manifestly apply if, Depreciation having, as in the foregoing instance, already occurred (whether of Leasehold or other Asset), a simple Reserve were shown on the Debit side of the Balance Sheet, the credit item not being subjected to the deduction of Depreciation.

	£	s.	d.	£	s.	d.
PLANT AND MACHINERY ...	**1600**	**0**	**0**			
Less DEPRECIATION ...	**112**	**0**	**0**			
				1488	**0**	**0**

This item usually appears at cost price subject to reduction from year to year by Depreciation, the appropriate rate of which depends on circumstances, and is an Estimate.

Here may be stated with regard to Depreciation in general that, instead of deducting year by year from the Asset the annual amounts reserved out of Profits for Depreciation, a similar result, so far as regards arithmetical correctness, would be arrived at

by stating them in total, on the Debit side, thus in fact forming a "Reserve" of the character referred to under the previous heading, Leasehold Buildings.

Had we before us the Profit and Loss Account for the year ending 31st December, 1901, and containing the details that result in the balance Profit of £700 which appears as the balance for that year in the specimen Balance Sheet, we should find, amongst the items of expenditure, Depreciation, perhaps in one sum, £589 5s. 6d., perhaps in the three items, £150, £327 5s. 6d., and £112, that have just passed under our notice and together amount to that figure. Depreciation being charged amongst expenditure in the Profit and Loss Account means, needless to say, deducting it from Profits; and here is an example of the two-fold aspect of all transactions that double-entry book-keeping so strongly manifests. By the fact of Depreciation being deducted from an Asset we learn that so much is treated as lost, whilst in the account designed to include a record of Losses—Profit and Loss Account—the Depreciation must also be entered, on the Expenses side. It is thus recorded in the

accounts as a Loss that, reducing the value of an Asset, at the same time reduces a Liability to the Shareholders—viz., the Profits.

STOCK IN TRADE or STOCK ON HAND, £1475.

This figure is arrived at by the valuation known as Stock-taking, made at the date of the Balance Sheet. The Stock should, to state a rule, be valued at either cost price or the market price of the day, in this case 31st December, 1901, when it is taken, whichever should happen to be the lower. This has the effect of providing for Depreciation if the value has fallen below cost; and, on the other hand, is to avoid anticipating Profit where the value has risen.

SUNDRY DEBTORS	**£640 10 0**	
Less DEBTS CONSIDERED DOUBTFUL AND BAD ...	**50 0 0**	
		£590 10 0

These Debtors owe £640 10s. to the Company for, let us say, goods the Company has supplied them with, this figure including such as are deemed to be Doubtful and Bad, together with Good Debts; Debts considered Doubtful and Bad, £50, being deducted, the result, £590 10s., is naturally the amount of

Debts to be considered Good. On taking up a Balance Sheet it may, however, be found that the amount of Good Debts only appears; without showing, for instance, the £640 10s. and the £50, the particulars given might be "Sundry Debtors after making provision for Debts considered Doubtful and Bad, £590 10s.," or even "Sundry Debtors, £590 10s.," the outer money column, the one that is totalled, remaining unchanged.

The sum of £50, besides reducing the amount of Sundry Debtors, has also been deducted from Profits. Here again is strongly pointed out that in double-entry book-keeping every transaction is shown to be of a two-fold nature. The worth of the Asset has fallen, as estimated, to the extent of £50, the amount provided against Bad and Doubtful Debts, which is therefore deducted so as to show the Debtors at a fair value. This apprehended decrease is thus dealt with as a Loss which must be placed amongst the Losses or Expenses, in the (detailed) Profit and Loss Account, as a deduction from the Profits.

Instead of being treated in the manner shown by the item now under our consideration,

the amount, £50, seeing that it is, in this instance, anticipatory, and not in respect of Debts proved to be bad, could be placed without impropriety as a Reserve for Bad and Doubtful Debts in the outer column on the Debit side of the Balance Sheet, whilst Sundry Debtors, £640 10s., would appear in the outer column on the Credit side. The crossing of items in this way is also referred to on a subsequent page. As already alluded to, the items of Depreciation and the Assets they are deducted from in the specimen Balance Sheet might be similarly, though in their case erroneously, treated, and still leave an arithmetically correct statement.

BILLS RECEIVABLE, £130 10s.

The meaning of this item is that certain Sundry Debtors, *not* included amongst those shown by the last item, instead of paying their debts, have given Bills (a term comprising both Bills of Exchange and Promissory Notes) payable to the Company in cash at some future date, and that the Company had these documents in hand and unpaid at date of Balance Sheet.

If they had been discounted, *i.e.*, cashed at a discount, by the Bankers, Bills Receivable would not appear in the Balance Sheet, whilst the proceeds would have increased Cash at Bank, leaving the Company with a Contingent Liability; for, should a debtor fail to pay off his Bill on its falling due, the Bank must not be the loser, but would look to the Company for repayment, and the Company in its turn would have to take whatever course against the Debtor that might be thought fit. If not already covered by an appropriate Reserve this Contingent Liability, assuming there is fear of loss, should be suitably provided for out of Profits, the amount so to be reserved depending on the merits of the case.

Had these Bills not been given to the Company, this item, £130 10s., if still unpaid, and eliminating any question of interest, would form part of the last item, Sundry Debtors, increasing it to £721, the two amounts added together.

The palpable object of this item is to show separately in the Balance Sheet the Debtors who have given such documents to the Company.

INVESTMENTS, £95 17s. 3d.

These are usually shown at cost price, in respect of which, however, any serious depreciation should at least be revealed.

The item, consisting of investments entirely outside the Company, is, in the present instance, intended to convey the meaning that £95 17s. 3d. out of the £100 Reserve, that appears on the Debit side, is thus represented.

CASH AT BANK, £388 16s. 6d.

CASH IN HAND, £24 0s. 10d.

These items speak for themselves. It may however be mentioned that a Bank balance on the Debit side would mean a loan or overdraft received from the Bankers and owing to them at date of Balance Sheet.

This concludes the explanation of the Credit side of the Balance Sheet, whereon appears a statement of what the Company has done with the Receipts shown on the Debit side—a statement of the Possessions that by virtue of those Receipts the Company has acquired,

and retained at date of Balance Sheet—Possessions that it holds as in trust for the persons, indicated on the Debit side, to whom the Receipts are attributed. And, as previously explained, should Losses have unfortunately occurred, they too appear, in case of Limited Companies, as an item on the Assets side of the Balance Sheet, representing a portion of the Receipts set forth on the Debit side that might have been used in acquiring Possessions but has been lost instead.

CHAPTER IV.

PROFIT AND LOSS, INCOME AND EXPENDITURE, AND RECEIPTS AND PAYMENTS ACCOUNTS.

THE Balance Sheet, being a concentration, or, to use an expressive term, a "boiling down" of the double-entry books, is thus a statement of the result, at a particular date, of the numerous changes that have taken place, since the concern's very commencement, in the different accounts contained in the books, and that are occasioned by the manifold transactions, large and small, involved in the carrying on of a business; and so, be it repeated, the Balance Sheet is an account of a concern's position at a given date, showing the Liabilities and the Assets.

The detailed statement entitled Profit and Loss Account is of a very different nature. In the specimen Balance Sheet we have

already met with the item, "Balance Profit for the year ending 31st December, 1901, £700." This figure is the balance or net result of the detailed Profit and Loss Account *for the year 1901*, which account, were it before us, would be found to set forth the gross Profits on one side and the various Expenses on the other, the excess of the former over the latter being this £700, the Balance for the year.

The Profit and Loss Account is therefore a statement showing in detail the Income, and the Expenditure chargeable against Income, of a concern for a definite period, usually one year.

Where the books are kept by double-entry, the Balance Sheet is a summary of all the Ledger Accounts, whilst the Profit and Loss Account is one of those Ledger Accounts.

Limited Companies, from motives of policy, do not, in many cases, publish a detailed Profit and Loss Account with the periodical Balance Sheet, and it has been thought unnecessary to supply a specimen herewith; moreover, the typical items need little or no explanation further than such as already has been incidentally given; suffice it to explain the

nature of the statement and the essential difference in principle between it and the Balance Sheet.

There should be mentioned that although in the Balance Sheet Receipts appear on the Debit side and Expenditure on the Credit, the reverse is the case with the Profit and Loss Account, as usually set forth, showing on the Debit side the Expenses and on the Credit side the gross Income. This method is now used, it may be presumed, as a matter of custom; but when a detailed Profit and Loss Account is submitted to those interested it would certainly be clearer, at the least, for the sides to be reversed so as to state Income on the Debit side and Expenditure on the Credit—a basis uniform with that of the Balance Sheet.

But in any case a perusal of an item or so will satisfy one as to which side shows Income and which shows Expenses, and the point is referred to solely with the object of guarding the novice against confusion should he find a Profit and Loss Account accompanying the Balance Sheet but not on the same footing in the respect mentioned.

The Income and Expenses in Profit and Loss Account are not only those received and paid in actual cash ; all Income earned during the period appears, whether received in cash or still owing to the Company ; and all Expenses incurred during the period, that are a charge against Income, appear, whether paid in cash or still owing from the Company. This, needless to say, is the indispensable principle for accurately determining the Profit or Loss made during the period.

But on perusing a detailed Profit and Loss Account one may, if one so desires, consider the Expenses as having been paid, and the Income as having been received, in cash ; they are all expressed in money, and the Account itself cannot reveal what proportion has been in cash and what has not. The error must, however, be avoided of assuming that at the end of the period the concern necessarily has in cash the balance Profit, the result of Profit and Loss Account for that period. It is requisite to consult the Balance Sheet to see if there is a sufficient cash balance on the Credit side to represent the balance of Profits on the Debit ; and even then it must be borne in mind

that ordinarily we are not entitled to assume any one item to be specially represented by any one item opposite, for, as previously stated, the items on the Debit side of a Balance Sheet are collectively represented by the items on the Credit.

The detailed Profit and Loss Account may be found shown in three parts—(1) The Trading Account, comprising Sales and Working Expenses; (2) the portion to which the balance of Trading Account is carried, here also appearing the Expenses of Management and any Income not strictly a Trading Profit; (3) this shows the balance of Part No. 2 brought down, together with items recording disposal of the Profit. Where such a method is followed it is merely for the sake of the greater information the analysis affords, and the final balance, of net Profit or Loss, is, of course, quite unaltered in the process.

Bearing in mind that the balance of Profit and Loss Account is in effect the result of deducting the total of the items on one side from that of the items on the other:—

The Profit and Loss Account may be found to state, on the Expenditure side, Stock

on Hand at commencement of period, and Purchases during period; and on the Income side, Sales during period, and Stock on Hand at end of period. It is puzzling for the novice to find Stock, an Asset, in an account that he is told contains Profit and Loss only. This, however, is only a mode of bringing in the gross Profit or Loss on Sales; for Stock at commencement added to Purchases of Stock during period, less Stock at end of period, leaves Stock used during period, whereof the figure (the exactitude of which, be it stated, is dependent on Stock-taking valuations) deducted from the amount of Sales, gives us the gross Profit on Sales. Of course, if the amount of Stock used be greater than that of the actual Sales, the latter deducted from the former would leave the gross Loss on Sales.

Should the reader find such particulars in a Profit and Loss Account he may be able to follow this explanation the more readily by tracing the items out on paper.

The Income and Expenditure Account is another periodical statement. It takes the place of Profit and Loss Account in case of Associations, Institutions, and the like, that

are carried on not for the purpose of paying dividends but with the object of paying their way in some non-trading pursuit. The difference between the Profit and Loss Account and the Income and Expenditure Account lies in the title, for both Accounts are composed of items of an Income nature, and of an Income nature only.

Another periodical statement is the Cash Account or Receipts and Payments Account. It is merely a summary of the Cash Book, and, unaccompanied by a Balance Sheet, is used in case of many Charitable Institutions and other organisations, where it is thought sufficient to show only the actual cash receipts and payments that have occurred during a period. This Account may be found to show Receipts on the Debit side and Payments on the Credit, but in any case there can be no difficulty in finding, by a glance at the items, which side is which.

To make now a comparison of the four statements upon which our attention has been directed:—

The Balance Sheet records transactions as to both Capital and Income.

The Profit and Loss Account records Income transactions only.

The Income and Expenditure Account records Income transactions only.

The Receipts and Payments Account records transactions as to both Capital and Income.

There is, however, the widest difference between a Balance Sheet and a Receipts and Payments Account; they are of entirely diverse natures, the former being a statement of the Liabilities and Assets at a given date, whilst the latter of the two shows merely the actual cash transactions during a given period, including any that relate to Capital as well as those of an Income character, but without setting forth the position of the Liabilities and Assets. The purchase of an Asset, for instance, would be shown in the Receipts and Payments Account for the period in which it was paid for, but the Asset would not be carried forward and appear in succeeding Accounts as it would in consecutive Balance Sheets.

The fact is that the three statements, Profit and Loss Account, Income and Expenditure

Account, and Receipts and Payments Account, are subsidiary to the Balance Sheet. As already stated, Profit and Loss Account and Income and Expenditure Account are different names applied to, in principle, the same statement.

The balance Profit, or Loss, appears as an item in the Balance Sheet, and the Profit and Loss Account shows the details by means of which that balance is arrived at.

The balance of Cash in Hand also appears in the Balance Sheet, and by summarising the contents for the year of the Cash Book so as to classify the items, we should arrive at a Receipts and Payments Account for such period, showing the details by means of which that balance is arrived at.

The aim having been to give the uninitiated a conception as to the essence of these subsidiary statements, our consideration of the subject may now be drawn to a close. To deal with the immense variety of items that occur in accounts were, needless to say, an interminable task. But after the reader has carefully considered the remarks upon the Balance Sheet and typical items thereof, and formed a clear notion of the construction of the

different subsidiary accounts referred to, he will find that the rest is a matter of reflection and perhaps a judicious enquiry. Regarding our subject in the main, the many debatable points, variations in form, and exceptions to be met with, render it a difficult one to generalise upon; a case is to be considered on its merits.

Some explanation may now be given of certain Balance Sheet items in addition to those already dealt with; it being deemed preferable to introduce them at the present stage, they were not included in the specimen Balance Sheet. Consideration of these items is entered upon in the next Chapter.

CHAPTER V.

EXPLANATION OF FURTHER BALANCE SHEET ITEMS.

PREMIUM ON SHARES.

THIS appears on the Debit side of the Balance Sheet. Supposing 10,000 Shares of the nominal value of £1 each in a Limited Company are issued to the public at £1 2s. per Share, each Shareholder is liable for £1 2s. in respect of every £1 Share allotted to him, the extra 2s. being the Premium. There is thus a Profit to the Company, but a Profit of the nature of Capital, an increase which, for a reason already mentioned, must not be added to the Capital in the Balance Sheet; it should be treated as a Reserve Fund for Capital purposes, and, if simply from a politic view, not paid away in dividend.

SUSPENSE ACCOUNT.

An item in suspense may appear on Debit or Credit side, according to its nature. It records some transaction that has taken place

prior to the end of the period, but which then remains in abeyance, awaiting final treatment in due course.

GOODWILL.

This appears on the Credit side. It is the value attached to a business over and above the valuation of the tangible Assets, and is generally calculated on so many years' purchase of average Profits, the number of years depending on the circumstances.

Goodwill is thus an Asset whose value is bound up with the concern's welfare; and, being usually stated in the Balance Sheet on the basis of cost, its amount cannot be assumed as a criterion of its worth.

There are opposing views as to the propriety of writing off this item against the Profits over a number of years; to do so would mean paying for it eventually out of Income instead of out of Capital; and the much debated question of Secret Reserves may here be touched upon: where the value of an Asset is not fully stated in the Balance Sheet, the amount that is absent represents an undisclosed Reserve—the merits of other Assets being of course kept in due regard.

PRELIMINARY EXPENSES.

A credit item, paid for out of Capital. It is not really an Asset, consisting as it does of expenses incurred in bringing the Company into existence; still there would be unfairness in charging the whole amount against the first year's Profits, for these expenses are preliminary, and will not occur as an annual expenditure; they ought, however, to be written off against Profits over a prudent term of years, showing in the Balance Sheet at a lower figure each year until the whole amount is written off, when the item disappears from the Balance Sheet, having thus been eventually paid for out of Profits.

UNEXPIRED INSURANCE.

This also appears on the Credit side. An Insurance premium frequently covers part of the year in which it was paid, and, to an appreciable degree, part of the next year as well. The portion attributable to the latter period is not chargeable against the Profits of the former year, at the end of which it is an Asset that should appear in the Balance Sheet, though it is of course a charge, when the time comes, against next year's Profits. In fact

this item amounts to treating the Insurance Company at date of Balance Sheet as a debtor to the concern for the unexpired portion of the premium; for next year the said Insurance Company will pay to the concern this debt, not in cash, it is true, but in an equivalent to cash, that is to say, in the benefit of Insurance.

Another credit item, involving the same principle, is Rates Unexpired, or some such title.

The ensuing have been dealt with here instead of at an earlier point, for the reason that as their form is not an accustomed one they were considered inappropriate for the specimen statement.

The form of Balance Sheet given with The Companies Act, 1862, is supplemented at the foot on the Debit side with these particulars:—

CONTINGENT LIABILITIES.

Claims against the Company not Acknowledged as Debts.—Moneys for which the Company is Contingently Liable.

This would be by way of a foot-note, a supplement to the Balance Sheet, showing

how the position of affairs may be modified at some future date; such information might have its effect on a distribution of Profits and be valuable to possess. Ordinarily, however, if a Contingent Liability has arisen, it should be reserved for, the Reserve naturally forming part of the Balance Sheet, and so obviating the use of a foot-note.

Regarding "Claims against the Company not Acknowledged as Debts," it of course does not follow there will be anything to pay; that remains to be seen, and is thus unascertained at date of Balance Sheet.

And so, too, in respect of "Moneys for which the Company is Contingently Liable;" there being apprehended that some event may take place after the date of the Balance Sheet and bring forth a liability.

CHAPTER VI.

THE BALANCE SHEET.—CONCLUDING REMARKS.

WHERE one figure is deducted from another in the inner column on either side of the Balance Sheet, and the result extended into the outer column, the one that is totalled, on the same side, an effect arithmetically equal is to be arrived at in all cases by a re-arrangement of the figures, removing the larger amount to the outer column, still on the same side, without any deduction, and the smaller figure to the outer column on the other side: the Balance Sheet would nevertheless balance, its totals being increased each by the same amount. It would be arithmetically correct in either way, though whether in either alternative a correct statement would be afforded or not is another matter, depending on the nature of the items themselves.

The experiment may be tried with items in the specimen Balance Sheet. For instance, Capital, £5250, which is of course a Debit, less Calls in Arrear, £50, which, being deducted from a Debit, is in principle a Credit, and the result extended into the outer column, £5200, a net Debit. Now strike out this last figure, £5200, and insert in its place the £5250; remove Calls in Arrear, £50, from the inner column on the Debit side to the outer column on the Credit side of the Balance Sheet, which will still balance, its totals being each augmented by the sum of £50; but the information it is desired to show in this instance is more clearly and properly conveyed by the particulars as they stand in the specimen Balance Sheet.

The reader will remember that this kind of thing has been referred to elsewhere in connection with Bad and Doubtful Debts, and Depreciation.

It is no doubt recognised that the converse process, that of deducting in the inner column a Debit from a Credit item, or *vice versâ*, and extending the result into the outer column, will reduce the totals of the outer columns each

to the same extent, without, therefore, impairing the arithmetical correctness of the Balance Sheet.

Such crossings for one's personal information may sometimes be useful, but must be judiciously made lest they lead to confusion.

And now with regard to headings: in the form of Balance Sheet set out in connection with The Companies Act, 1862, the two sides which are respectively headed, "Capital and Liabilities," and "Property and Assets." The Balance Sheets of some concerns will be found headed simply "Liabilities" on the one side, and "Assets" on the other. There are those who prefer the headings, "Capital, Liabilities, &c.," and "Property, Assets, &c.," of which the former emphasises the distinction between Capital and other debts, the "&c." being intended to cover items that might almost be styled "Nominal" Liabilities, as, similar to Capital, not in the ordinary course actually payable; whilst under the latter heading of the two are covered Property and other Assets, the "&c." in this case being meant to include any Losses, and any Nominal Assets,

which, in fact, amount to the same thing as Losses, for there is no real value in them. Preliminary Expenses is a Nominal Asset; Goodwill may be, depending on the circumstances—any Asset that has suffered a shrinkage in the value stated in the Balance Sheet, without Depreciation being suitably provided for, is partly a Nominal Asset: these instances will illustrate the meaning of the term.

The periodical Balance Sheet certified by the Auditors, the Directors' Report, &c., that are, as a rule, printed, and sent to the Shareholders each year, should be carefully considered by those interested instead of receiving, as they very often do, a mere hasty glance. It may be mentioned that, under The Companies Act, 1900, Auditors are required, in addition to signing a Certificate, to make a Report on the Balance Sheet, and this the Directors are not obliged to send out to the Shareholders, though it must be read to them at their General Meeting. So that if the Auditor's Report does not appear as incorporated with the Certificate, or otherwise published, a Shareholder to make certain of its contents should attend the General Meeting.

In conclusion, the writer trusts that a perusal of these pages will materially aid the generality of Shareholders in Limited Companies, as well as others; that it will enable and dispose them to take a more lively interest than has formerly been evinced in the concerns with which their Capital—sometimes their all—has been entrusted.

Cr.

		£ s. d.	£ s. d.
....	....		1,500 0 0
....	....	3,000 0 0	
....	....	150 0 0	2,850 0 0
...	...	3,600 0 0	
....	....	327 5 6	3,272 14 6
....	....	1,600 0 0	
....	....	112 0 0	1,488 0 0
....	....		1,475 0 0
....	....	640 10 0	
....	....	50 0 0	590 10 0
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